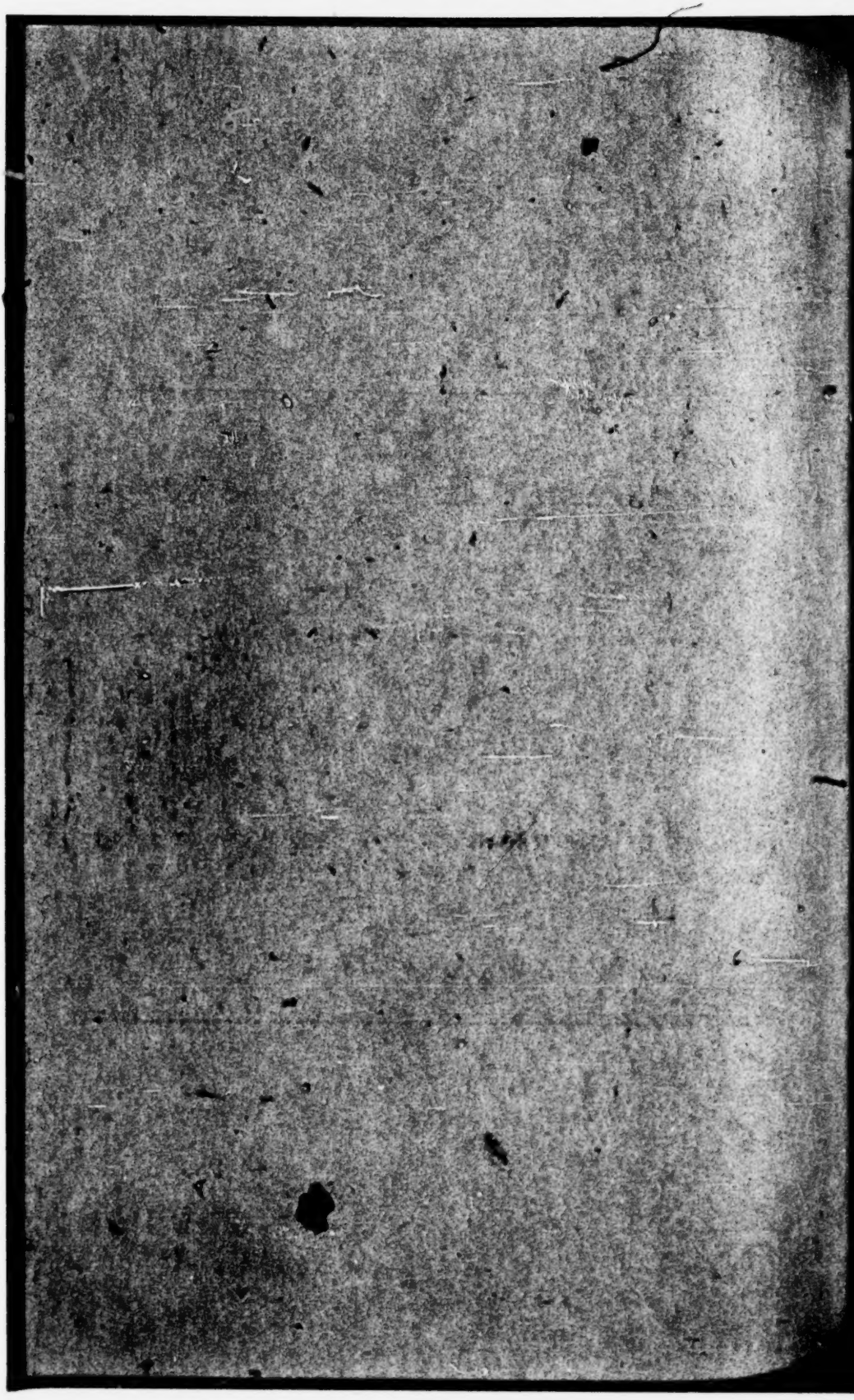

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1930.

No. 31.

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DAVID BURNET, COMMISSIONER OF INTERNAL REVENUE,
*Petitioner,*

v.

SANFORD & BROOKS COMPANY.

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**ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FOURTH CIRCUIT.**

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## BRIEF FOR THE RESPONDENT.

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### Opinions Below.

The opinion of the Circuit Court of Appeals (R. 20-25) is reported in 35 F. (2d) 312. The opinion of the Board of Tax Appeals (R. 8-14) is reported in 11 B. T. A. 452.

### Jurisdiction.

The judgment of the Circuit Court of Appeals (R. 28) was entered October 18, 1929. The petition for a writ of *certiorari* was filed January 16, 1930, and was granted March 3, 1930 (R. 29-30), 281 U. S. 707. The jurisdiction of this Court rests on Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925.

### Statutes Involved.

The statutes and regulations involved are set forth in the Appendix, *infra,* p. 21.

## Question Presented.

Should there be included in its taxable income for the year 1920, the amount received by the respondent during that year, in payment of a judgment in its favor against the United States, the amount of which judgment represents the difference between the amount of expenditures made by the respondent in the performance of a contract with the United States and the amount theretofore paid to it, the amount of the judgment including no profit, but being simply compensatory of the cost of the work done of which the Government got the benefit?

## Summary of Argument.

I.

The XVI Amendment to the Constitution authorizes the collection of taxes on income only and no statute or regulation fixing the method of arriving at taxable gain is valid if it results in making taxable something which is not income.

II.

This Court, the lower courts and the Board of Tax Appeals have defined income as and the definition of income as used in common speech means, "gain" as distinguished from reimbursement of a loss.

III.

The Revenue Act cannot make subject to tax that which is not gain, by requiring that it be considered as gross income and that its character as taxable or non-taxable, be dependent upon whether or not there are deductions permitted from gross income which would exhaust the item in question, that is to say, an item, which does not represent net

income subject to tax cannot be made taxable by any requirement of the statute that it be considered gross income in the first instance, regardless of what the real character of the item may be.

IV.

The fact that the taxpayer in arriving at its liability for taxes for the years 1913, 1914, 1915 and 1916 deducted from its gross income the amount of the losses which were refunded as a result of the payment of the judgment, cannot change the character of the payment received in 1920 and if that payment is not taxable it cannot be made so because of the fact that failure to tax it, on account of limitations or for any other reason, results in giving to the taxpayer a reduction in the amount of its taxes to which it is really not entitled, by virtue of its having made the deduction of losses, in the earlier years.

V.

That since the jurisdiction of the Circuit Court of Appeals for the Fourth Circuit, to render a decision requiring that amended returns be filed for the years 1913-1916 eliminating the deduction claimed in those years in aggregate amount equal to the amount of the judgment, was raised for the first time in the petition for writ of *certiorari*, this Court should refuse to consider it.

VI.

That Section 274 (g) of the Act of 1926 is not applicable to the instant case and the Circuit Court of Appeals did have jurisdiction to render its decision directly affecting tax liability for the years 1913 to 1916.

## ARGUMENT.

### I.

### Income Only Can Be Taxed.

Federal income taxes are levied solely under the authority so to do conferred upon Congress by the XVI Amendment to the Constitution; it gives the power

> "to lay and collect taxes on incomes, from whatever source derived * * *."

To the extent that the taxing statutes and the regulations passed pursuant to the provisions thereof, impose a tax on money or property as income, which is not a realized addition to the taxpayer's property, they are unconstitutional.

The money received in payment of the judgment, which the Government contends is subject to tax was not paid to respondent in accordance with the terms of the contract between it and the United States but represented a reimbursement by the Government of the amount which had been expended by the taxpayer for work and presumably also for materials, of which the Government got the benefit; if during the year 1920, the taxpayer having ceased to operate, had had no deductions from gross income, then if the contention of the Government is correct, the taxpayer would be assessed on money that represented no addition to its capital, no gain, no profit but simply a return of money or capital, the amount of which it had had and had expended and which pursuant to the judgment was being returned to it; such a condition can arise only when the work is done and expenditures are made during one accounting (tax) period and the reimbursement is made in another such period.

The character of the payment in the case at bar is not we submit, income subject to tax.

## II.

### Income Implies Gain.

Differences between the Government and taxpayers as to what constitutes income, have been presented for decision to this Honorable Court and to the lower courts in cases so numerous and so varied as to the facts presented, as to preclude quotations from them except in only a few instances in which the questions of law presented were most apposite to those presented in the case at bar. These would seem to be—

(a) Eisner v. Macomber, 252 U. S. 189 (1919);
(b) Doyle v. Mitchell Bros. Co., 247 U. S. 179 (1918);
(c) Inland Products Co. v. Blair, 31 Fed. (2d) 867 (1929);
(d) Bowers v. Kerbaugh-Empire Co., 271 U. S. 170 (1926).

The facts in the two cases first cited are in no sense analogous to those in the case at bar, but in the other cases, the analogy is close; in all the cases, however, the meaning of the term "income" as used in the XVI Amendment is defined; in these cases the holding was:

Eisner v. Macomber, at page 207:

> "For the present purpose, we require only a clear definition of the term 'income' as used in common speech, in order to determine the meaning in the Amendment."
>
> "Income may be defined as the gain derived from capital, labor, or from both combined."

Doyle v. Mitchell Bros. Co., at pages 184 and 185:

> "Whatever difficulty there may be about a precise and scientific definition of 'income', it imports as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; conveying rather the idea of gain or increase arising from corporate activities."

Inland Products Co. v. Blair:

In this case taxes on products manufactured by it were paid in 1919 and 1920; in 1924 the amount paid was refunded as having been collected erroneously and without warrant of law. *Held*, that the amount refunded was not to be added to the corporate income of the petitioner for the year in which it was received but that its "Returns" for the years 1919 and 1920 in which the amount paid had been deducted, should be restated for the purpose of eliminating the deductions.

We submit that there is no distinction in principle, between the return of taxes improperly paid to the Government and the refund of the amount of moneys expended for its account and which it was required to refund.

Finally, as to the cases above cited, Bowers v. Kerbaugh-Empire Co. is so much in point as to the facts as to be, we submit, conclusive of the case at bar. In this case, the taxpayer, a corporation, owned all of the capital stock of a second company, Kerbaugh, Inc., a corporation engaged in the contracting business. To finance the operations of the subsidiary, the taxpayer borrowed from a German bank in the years 1911 to 1913, inclusive, certain moneys for which it issued its promissory notes payable in marks. The funds borrowed were lost in their entirety by the subsidiary in the conduct of its business during the years 1913, 1914, 1916, 1917 and 1918; the loss in each of these years was allowed as a deduction in the income tax returns of the subsidiary. In 1921, the taxpayer paid in full the claim held against it by the German bank, the settlement, due to the depreciation in value of the marks, amounting to $684,456.18, less than the amount borrowed, in dollars. The Government contended that the saving constituted income for the year 1921; on appeal to this Honorable Court, it was held that the amount saved due to the depreciation of the mark, was not income but was a mere diminution of loss; the opinion held, at p. 175—

> "The contention that the item in question is cash gain disregards the fact that the borrowed money was

lost, and that the excess of such loss over income was more than the amount borrowed. When the loans were made and the notes given, the assets and liabilities of defendant in error were increased alike. The loss of the money borrowed wiped out the increase of assets, but the liability remained. The assets were further diminished by payment of the debt. The loss was less than it would have been if marks had not declined in value; but the mere diminution of loss is not gain, profit or income."

The same thought was succinctly put in an income tax case, construing the word "income" as used in the Eng-151, 164, in which Lord MacNaughten observed that a person is liable for income taxes—

"not on what saves his pocket, but on what goes into his pocket."

Tennant v. Smith, A. C. 151.

It is submitted that no material distinction can be drawn between the instant case and that of Bowers v. Kerbaugh-Empire Co. The Board of Tax Appeals in passing upon the case at bar, contended that the cases were distinguished because in the latter case, the Court was dealing with the liquidation of liabilities for a smaller sum in dollars than the face amount thereof, which at best could be called negative income, whereas in the instant case, it was dealing with positive income, the receipt of money. We submit that this begs the question; what is not income cannot be made so by calling it such. The payment in the instant case was not made pursuant to the contract, it was not made on a *quantum meruit* basis and it involved no payment of profit, the amount of the payment being simply the difference between expenditures made for doing the work and the amount theretofore paid on account of those expenditures, this Court holding in its opinion that the judgment was in no way punitive but that it was simply compensatory of the cost of the work, of which the Government got the benefit; to return the cost of work can mean only the return

of money paid out, the return of that which the taxpayer had before it was expended for the account of the Government.

Counsel for the Government has attempted to distinguish this case in his brief in the support of his petition for writ of certiorari, page 17, as follows:

> "In the instant case there was a transaction arising out of the operation of a business where compensation was collected for work performed in earlier years, the expenditures made in performing the work having been properly deducted in those years. In the Kerbaugh-Empire Co. case the whole transaction was a capital transaction."

The amount of the judgment was not payment in compensation for work performed: the Kerbaugh case involved no more a capital transaction than the instant case. The money borrowed from the German bank became upon its receipt, an asset in the form of cash; when the amount was lost, the loss was an operating one and reduced the assets just as in the instant case. In both cases capital was affected only in so much as a corporate operating loss is finally reflected in the decreased value of capital assets.

Other illustrative cases although not so clearly in point are—

(a) Marshall v. The Commissioner of Internal Revenue, 10 B. T. A. 1140 (1928);
(b) United States v. Supplee-Biddle Co., 265 U. S. 189 (1924);
(c) Merchants L. & T. Co. v. Smietanka, 255 U. S. 509 (1920).

In its petition to this Honorable Court for certiorari, the Government insists that inasmuch as the amount of the judgment was paid for work performed, the payment is identically the same as the payments made under the contract at unit prices fixed therein; this is a manifest error, the judgment represents no payment at unit prices and was

in no sense a payment made pursuant to the contract which provided for payment at a fixed price per cubic yard of earth removed.

United States v. Atlantic Dredging Co., 253 U. S. 2.

Certainly until capital expended in any transaction has been made good, the transaction cannot yield a profit and what is not a profit as t o a single transaction cannot be converted into a profit by lumping that transaction with others had by the taxpayer.

Merchants L. & T. Co. v. Smietanka, 255 U. S. 509.

If the taxpayer in the instant case, had been a copartnership and a partner had withdrawn at the end of 1916 and had been paid his pro-rata share of the assets of the company, the claim against the Government which resulted in the judgment, the amount of which it is sought to tax in this case, being at that time unknown to any of the partners, could it be seriously contended that the retiring partner would not share in the amount recovered in 1920, an amount which was due in 1916 although it was not at that time known to any of the partners, and could the interest of the retiring partner be depleted by charging against the recovery on an asset which was in existence when he retired, losses incurred four years later through the operation of a partnership in which he had at the time no interest; yet if the amount of the judgment is income for the year in which received, for tax purposes, it should be income for all purposes in the absence of a special agreement relating to it.

## III.

### No Requirement as to Method of Establishing Income Subject to Tax Can Convert a Reimbursement Into a Gain.

The contention of the Government is based entirely on the wording of Sections 213, 232, 233, and 234(a) of the Revenue

Act of 1918. We submit the strict wording of these sections does not justify the conclusion for which it contends.

Section 213 provides that gross income shall include gains, profits and income derived from salaries, wages or compensation for personal services * * * from professions, vocations, trades, businesses, commerce or sales * * * also from the transaction of any business carried on for gain or profit, or gains and profits or income derived from any source whatever; that the amount of such items shall be included in the gross income for the taxable year in which received, subject to certain exceptions not material as to this case.

Section 234(a)(1) provides that corporate income shall be subject to deductions for expenses incurred in carrying on the corporate trade or business, for interest and taxes paid, losses sustained and not compensated for, debts ascertained to be worthless and charged off, the amount of dividends received from a corporation which is taxable and reasonable allowance for exhaustion, wear and tear and obsolescence.

No system of bookkeeping or requirement as to the manner or method of arriving at taxable gain, however clearly set forth and provided by statute, can convert into income that which is in fact not income; nor can money be made subject to tax by statutory requirement that it be included in gross income of the taxpayer, if it would not be taxable were it net income, that is to say, if it would not be taxable if it constituted the sole receipt of the taxpayer during the year in question and if during that year the taxpayer was entitled to no deduction from gross income.

If the contention of the Government is correct, then it must admit this to be true; if in 1920, the respondent had ceased operations, had reduced its capital to a nominal sum, had no employees or expenses of any kind, except only such expenses as are incident to the maintenance of its corporate existence, such as annual franchise taxes and the like, and had disposed of every asset it had and had then received the amount in question, the entire amount subject only to the payment of nominal franchise taxes, would have been

net income and the taxpayer would have been taxed on the entire amount of it, notwithstanding the fact that it represented only the return to it of moneys that it had expended; no possible construction or requirement of the statute as to method of arriving at taxable income, can justify such a finding.

Had there been no misunderstanding between the Government and the contractor and the amount that was paid in 1920 had been paid as it had been expended by the taxpayer in 1913, 1914, 1915 and 1916, the amount paid would have exactly off-set the expenditures to refund which it was decreed to be paid; the taxpayer would have been no better off and no worse off than if the expenditures had never been made, the amount of the payment would never have been net income subject to tax; by withholding the payment, by mere lapse of time, it is contended by the Government that what was not net income has been made such.

## IV.

### Estoppel Cannot Prevail Against Respondent.

Nor can the fact that the amount of expenditures made and subsequently refunded as operating charges, reduced the income of the taxpayer for the years 1913, 1914, 1915 and 1916 and changed its liability for taxes from what it would have been had the refunds been made, require the taxpayer to account for the money when subsequently received as in the case of a bad debt charged off and later recovered. Until after 1916, the taxpayer had no knowledge of the existence of the indebtedness of the Federal Government to it and the charging off of the amounts expended and subsequently refunded was in no sense analogous to the charging off of a bad debt. The only debts which are permitted to be charged off under the act, are

> "debts ascertained to be worthless and charged off within the taxable year."

No amount of money can be deemed to be charged off as a debt when the person charging it off does not claim that

it is due to him by any one and does not recognize its existence as a debt. No such charge off was made by the taxpayer. (Findings of Fact, B. T. A., Record, page 9.)

Moreover and finally, we submit, that whatever the taxpayer did with reference to the amount expended and subsequently refunded, in the years 1913, 1914, 1915 and 1916 cannot change the character of the receipt in 1920. If the amount of the judgment has been properly paid to the taxpayer, then the amount of it was due in 1913, 1914, 1915 and 1916 and the taxpayer was in error in deducting the amount of it in arriving at its net income subject to tax and the charging off of the same was due to a mistake on its part, as well as on the part of the Government. Properly the mistake should be corrected but that is all; it cannot be adjusted through permitting the mistake to persist and attempting to correct it by changing the nature of the amount repaid. The deduction should not have been made in the earlier years and the taxpayer has filed amended returns to eliminate the deductions; if for any reason, lapse of time, or otherwise, additional taxes for the earlier years cannot be collected which might be found due upon correction of the mistakes, it is not an answer to substitute for taxes thus uncollectible as a result of a given transaction, something different. We respectfully submit that the amount of the payment is not income.

## V.

### Jurisdictional Question Cannot Be Raised.

We submit that if it be conceded that the Circuit Court of Appeals did determine tax liability of the respondent for the years 1913, 1914, 1915 and 1916 or re-determined such liability and that it was without jurisdiction so to do and if it be conceded also that through lapse of time or for some other reason, it will not be possible for the Government to collect taxes which might be found due upon a restatement of the returns for those years, eliminating as deductions the loss which has been reimbursed

through the payment of the judgment, all of these facts would still not justify the finding that the amount of the judgment was income for the year 1920.

> "the fact that a taxpayer has paid lower taxes for prior years than those which were rightfully due, because of erroneous computations of taxable income, and that the statute of limitations now bars the assessment and collection of any deficiency for those years, does not justify an erroneous computation of its tax liability for any subsequent year."
>
> Appeal of Macmillan Co., 4 B. T. A. 251, 253 (1926).

Inasmuch, however, as the jurisdiction of the Circuit Court of Appeals to determine any question directly affecting the respondent's liability for taxes for the years 1913 to 1916 was not advanced by the Government, except as one of the bases urged by it for the grant of *certiorari*, this Court should not consider the question.

> "* * * This Court sits as a court of review. It is only in exceptional cases coming here from the federal courts that questions not pressed or passed upon below are reviewed."
>
> Duignan v. United States, 274 U. S. 195, 200 (1927).

In Blair vs. Oesterlein Machine Co., 275 U. S. 220 (1927), this Court decided what we submit is the exact question here presented in favor of the contention that we have just advanced. The Machine Company paid taxes for 1918, 1919 and 1920; the returns for the three years were considered as an entirety by the Commissioner who reduced the taxes in one year, increased them in another and found a net deficiency; the company filed an appeal with the Board of Tax Appeals which issued a subpoena to compel the Commissioner to answer certain interrogatories; he denied the authority of the Board on the ground that no appeal could be taken from any determination made by him under the sections of the Revenue Act involved and that,

therefore, the Board of Tax Appeals was without jurisdiction. The Supreme Court of the District of Columbia in a proper case, directed the Commissioner to obey the subpoena of the Board of Tax Appeals which decree of the lower Court was affirmed by the Court of Appeals of the District of Columbia. The Commissioner in an application for *certiorari* specified as error to be urged, only his original contention as to the lack of jurisdiction of the Board of Tax Appeals; *certiorari* was granted and the Commissioner then for the first time, suggested that as no deficiency had been found for one of the years under consideration, the Board of Tax Appeals was without jurisdiction to determine tax liability as to that year. This Court held that it sits as a court of review and would not consider the second issue raised by the Commissioner.

At page 225 of the report of the case, Mr. Justice Stone delivering the opinion, said:

> "We think the question suggested is not properly before us. It was not specifically raised on the record before the Board or either court below and, so far as appears, was not considered by any of them. We were asked to grant *certiorari* only to pass upon the question whether the Commissioner's determinations under P. 327 and P. 328 may be appealed to the Board of Tax Appeals. This Court sits as a court of review. It is only in exceptional cases, and then only in cases from the federal courts, that questions not pressed or passed upon below are considered here. Duignan vs. United States, 274 U. S. 195. There are specially cogent reasons why this rule should be adhered to when the question involves a practice of one of the great departments of the government. Hence we do not pass upon this aspect of the case with respect either to the return or the amended return for 1918, and our decision is without prejudice to the disposition of the question wherever appropriately presented."

It is true that in the instant case, the jurisdiction was questioned in the petition for certiorari which was not true in the case from which the above citation was made. The distinction, however, is not material, this Court expressly holding that the question was not properly before it and that it was only in exceptional cases that questions not passed upon below are considered.

In another case, however, Saltonstall v. Birtwell, 164 U. S. 54, 70 (1896), error of the Circuit Court was first claimed upon petition for certiorari. This Court held that where there was no assignment of error in the trial court and the question was not considered in the Circuit Court of Appeals it was not incumbent upon this Court to consider it even though raised in the petition for writ of certiorari. In the opinion at page 70, the Court said:

> "* * * Nor do we consider it incumbent on us to consider whether there was error in the Circuit Court, as a matter of practice, in directing judgment upon the special findings in favor of the importer. No such error was assigned in the Circuit Court, or was considered in the Court of Appeals, but it first appeared in the application for the writ of certiorari."

We are not unmindful of the decision of this Court in Green County v. Thomas' Executor, 211 U. S. 598 (1909). It is submitted, however, if this Court finds that the amount of the judgment was not income for the year 1920 as contended by the Government, that no substantial right could be served by reversing the decision of the Circuit Court of Appeals on the ground that although its finding was correct that there was no tax due, its decision should be reversed nevertheless because of the fact that it held the respondent liable for additional taxes for the years 1913 to 1916, although it was without jurisdiction so to do.

## VI.

### Jurisdiction of Circuit Court of Appeals.

The Government in its petition for *certiorari* assigned as error the fact that the Circuit Court of Appeals had considered and decided—

> "questions directly affecting tax liability for the taxable years 1913 to 1916, when such taxable years were not involved in the taxpayer's petition to the Board of Tax Appeals";

and in its brief, in support of the petition, maintained that under Section 274(g) of the Revenue Act of 1926, the jurisdiction of the Board of Tax Appeals was limited so that it could determine facts for years other than 1920, only to the extent required for a correct determination of the taxpayer's liability for 1920 and that it was prohibited under the aforementioned section of the Act, from finding an overpayment or underpayment for those years.

There was no such restriction on the jurisdiction of the Board of Tax Appeals in the Revenue Act of 1924. The Government in its brief, page 24, admits that—

> "Before the passage of the Revenue Act of 1926 the Board did have jurisdiction as to years for which the Commissioner had determined no deficiency."

We submit that the appeal in the instant case is governed by the provisions of the Revenue Act of 1924 and that Section 274(g) of the Act of 1926 is not applicable. The proceedings in the matter of the appeal as to dates, are as follows:

> June 22nd, 1925, letter from the Bureau to the taxpayer, advising of the finding of a deficiency (R. p. 5);
>
> November 17th, 1925, formal notice to the taxpayer of the amount of the deficiency claimed. In this letter the Commissioner advises as follows (R. p. 5):

"In accordance with the provisions of Section 274 of the Revenue Act of 1924, you are allowed 60 days from the date of mailing of this letter within which to file an appeal to the United States Board of Tax Appeals";

January 16th, 1926, appeal to the United States Board of Tax Appeals filed (R. p. 2);

February 23rd, 1926, answer of the Commissioner of Internal Revenue filed (R. p. 6).

The Act of 1926 by its terms, provided that it should take effect as of January 1, 1925, except as to Section 257 and Sections 271 to 285, inclusive, and that these sections should take effect upon the enactment of the Act; the Act was approved on February 26th, 1926.

Section 274 of the Act of 1926, therefore, became effective on February 26th, 1926, subsequent to the date of the filing of the appeal and of the answer.

The Act of 1926 provides:

Section 283(b):

"If before the enactment of this Act any person has appealed to the Board of Tax Appeals under subdivision (a) of Section 274 of the Revenue Act of 1924 (if such appeal relates to * * * so much of an income * * * tax imposed by any of the prior Acts enumerated in subdivision (a) of this section, Act of 1918 enumerated as was not assessed before June 3, 1924), and the appeal is pending before the Board at the time of the enactment of this Act, the Board shall have jurisdiction of the appeal. In all such cases * * * the jurisdiction of the Board and of the courts, shall be determined * * * in the same manner as provided in subdivision (a) of this section, except as provided in subdivision (j) of this section and except that the person liable for the tax shall not be subject to the provisions of subdivision (d) of Section 284."

Section 283(a):

"If after the enactment of this Act the Commissioner determines that any assessment shall be made in respect of any income * * * tax imposed by * * * the Revenue Act of 1918 * * * or by any such Act as amended, the Commissioner is authorized to send by registered mail to the person liable for such tax notice of the amount proposed to be assessed, which notice shall, for the purposes of this Act, be considered a notice under subdivision (a) of Section 274 of this Act. In the case of any such determination the amount which should be assessed * * * shall * * * be computed as if this Act had not been enacted, but the amount so computed shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including the provisions in case of delinquency in payment after notice and demand and the provisions prohibiting claims and suits for refund) as in the case of a deficiency in the tax imposed by this title, except as otherwise provided in Section 277 of this Act."

Section 283(j):

"In cases within the scope of subdivision (b) * * * of this section where any hearing before the Board has been held before the enactment of this Act and the decision is rendered after the enactment of this Act, such decision shall, for the purposes of this title, be considered to have become final upon the date when it is rendered and neither party shall have any right to petition for a review of the decision. * * *"

The instant case, therefore, comes within the provisions of Section 283(b) of the Act of 1926, providing—

(1) that "the Board shall have jurisdiction of the appeal," under Section 274(a) of the Revenue Act of 1924; and

(2) the questions of jurisdiction "shall be determined * * * in the same manner as provided in subdivision (a) of this section" (283).

Section 283(a) provides that the "amount which should be assessed * * * shall * * * be computed as if this Act had not been enacted."

Section 283(j) does not qualify the above since there was no "hearing" in the instant case before the Board of Tax Appeals prior to February 26th, 1926.

We submit, therefore, that Section 274(g) does not control the jurisdiction of the Board of Tax Appeals in the instant case and that there is no such limitation on the Circuit Court of Appeals as is contended for by the Government, but that it had jurisdiction to determine tax liability for the years 1913 to 1916.

Appeal of E. J. Barry, 1 B. T. A. 156 (1924);
Appeal of Hickory Spinning Co., 1 B. T. A. 409 (1925);
Appeal of Eagle Dye Works, 1 B. T. A. 638 (1925).

## CONCLUSION.

Finally, it can scarcely be said with accuracy that the decision of the Circuit Court of Appeals did decide questions directly affecting tax liability for the years 1913 to 1916. The record shows that the respondent had filed amended returns, not as contended for by the Government, for the purpose of admitting that the amount of the judgment was income allocable to the years 1913 to 1916 but for the sole purpose of correcting a mistake in the returns for those years, by decreasing the amount of deductions claimed; whether the amendment took the form of an addition to income as originally reported or a diminution in the amount of deductions as so reported could not change the fact, namely, that the amount of the deductions was decreased by the amount of the refund. The Circuit Court of Appeals held that the amount of the judgment was income for 1920 but that being the fact, the deductions claimed in the earlier years were erroneous. We submit

that it had the right to pass on questions directly affecting tax liability for the previous years and that in any event, it was not a finding of tax liability but simply a holding that an admitted mistake should be corrected.

A very considerable argument is made in the brief for the Government as to whether the contract which gave rise to the expenditures which were refunded by the judgment, is a long term contract as defined in the income tax regulations and a very considerable argument is made dealing with whether or not the books of the taxpayer were kept on a receipt or accrual basis and whether the amount of the judgment should be accounted for as of the date received or as of the date accrued.

Both questions seem to us immaterial, the question being whether or not the payment is income. In this connection, it is well to realize that prior to 1916 books could not be kept on an accrual basis and income tax liability accounted for on that basis and that the judgment which established the right to the money was rendered, and the amount was paid in the same tax year.

We respectfully submit that the amount of the payment is not gain; it represents nothing but a return to the taxpayer of moneys that it had and had expended, and that no method prescribed by statute for the ascertainment of income subject to tax, can convert into gain what is not gain but the return of one's own moneys; that the Circuit Court of Appeals had authority to direct the correction of the mistakes made by the deductions in 1913 to 1916 of the losses the amount of which was refunded but that even if it had no such authority, its decision holding the amount of the judgment to be non-taxable income should be affirmed.

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# APPENDIX.

## STATUTES.

The Revenue Act of 1918, c. 18, 40 Stat. 1057, 1064, 1065, 1077, provides in part:

### TITLE II.—INCOME TAX.

* * * * *

### PART II.—INDIVIDUALS.

* * * * *

SEC. 212. (a) That in the case of an individual the term "net income" means the gross income as defined in Section 213, less the deductions allowed by Section 214.

(b) The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made upon such basis and in such manner as in the opinion of the Commissioner does clearly reflect the income. * * *

SEC. 213. That for the purposes of this title (except as otherwise provided in Section 233) the term "gross income"—

(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business

carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of Section 212, any such amounts are to be properly accounted for as of a different period * * *.

PART III.—CORPORATIONS.

* * * * *

Sec. 232. That in the case of a corporation subject to the tax imposed by Section 230 the term "net income" means the gross income as defined in Section 233 less the deductions allowed by Section 234, and the net income shall be computed on the same basis as is provided in subdivision (b) of Section 212 or in Section 226.

Sec. 233. (a) That in the case of a corporation subject to the tax imposed by Section 230 the term "gross income" means the gross income as defined in Section 213 * * *.

Sec. 234. (a) That in computing the net income of a corporation subject to the tax imposed by section 230 there shall be allowed as deductions:

(1) All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered, and including rentals or other payments required to be made as a condition to the continued use or possession of property to which the corporation has not taken or is not taking title, or in which it has no equity;

(2) All interest paid or accrued within the taxable year on its indebtedness * * *;

(3) Taxes paid or accrued within the taxable year * * *;

(4) Losses sustained during the taxable year and not compensated for by insurance or otherwise;

(5) Debts ascertained to be worthless and charged off within the taxable year;

(6) Amounts received as dividends from a corporation which is taxable under this title upon its net income * * *;

(7) A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence;

[The extracts of subparagraphs (2), (3), and (6) given above are by no means complete. All that we have attempted to do is to indicate the general nature of the deductions allowed. Other classes of deductions are also specifically provided for in subparagraphs (8) through (14).]

The Revenue Act of 1926, c. 27, 44 Stat. 9, 55, 56, 110, provides in part:

Sec. 274. (a) If in the case of any taxpayer, the Commissioner determines that there is a deficiency in respect of the tax imposed by this title, the Commissioner is authorized to send notice of such deficiency to the taxpayer by registered mail. Within 60 days after such notice is mailed (not counting Sunday as the sixtieth day), the taxpayer may file a petition with the Board of Tax Appeals for a redetermination of the deficiency. Except as otherwise provided in subdivision (d) or (f) of this section or in Section 279, 282, or 1001, no assessment of a deficiency in respect of the tax imposed by this title and no distraint or proceeding in court for its collection shall be made, begun, or prosecuted until such notice has been mailed to the taxpayer, nor until the expiration of such 60- day period, nor, if a petition has been filed with the Board, until the decision of the Board has become final. * * *

(b) If the taxpayer files a petition with the Board, the entire amount redetermined as the deficiency by the decision of the Board which has become final shall be assessed and shall be paid upon notice and demand from the collector. No part of the amount determined as a deficiency by the Commissioner but disallowed as such by the decision of the Board which has become final shall be assessed or be collected by distraint or by proceeding in court with or without assessment.

* * * * *

(g) The Board in redetermining a deficiency in respect of any taxable year shall consider such facts with relation to the taxes for other taxable years as may be necessary correctly to redetermine the amount of such deficiency, but in so doing shall have no jurisdiction to determine whether or not the tax for any other taxable year has been overpaid or underpaid.

Sec. 1003. (a) The Circuit Courts of Appeals and the Court of Appeals of the District of Columbia shall have exclusive jurisdiction to review the decisions of the Board (except as provided in Section 239 of the Judicial Code, as amended); and the judgment of any such court shall be final, except that it shall be subject to review by the Supreme Court of the United States upon *certiorari*, in the manner provided in Section 240 of the Judicial Code, as amended.

(b) Upon such review, such courts shall have power to affirm or, if the decision of the Board is not in accordance with law, to modify or to reverse the decision of the Board, with or without remanding the case for a rehearing, as justice may require.